

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Knight Analyst: Angela Raygoza Bill Number: AB 340
Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 18, 2009
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employee Tax Credit

SUMMARY

This bill would provide a tax credit for the wages paid to qualified employees, as specified.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide a tax incentive to businesses to stimulate the economy and promote hiring in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

Current federal law allows employers who hire employees from a "targeted group," as defined, to elect to claim a work opportunity credit (WOTC)¹. The credit is equal to 40 percent of the qualified first-year wages for that year. The amount of the qualified first-year wages that may be taken into account with respect to any individual shall not exceed \$6,000 per year (\$12,000 per year in the case of any individual who is a qualified veteran).

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

¹ Internal Revenue Code (IRC) section 51 defines the Work Opportunity Credit

Board Position:

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Department Director

Date

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Under the Government Code, state law provides for several types of geographically targeted economic development areas (G-TEDAs): Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within a G-TEDA. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within G-TEDAs and a credit for employees working in an EZ.

Hiring Credit: A business located in a G-TEDA is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a G-TEDA and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the G-TEDA and at least 50 percent of the employee's services must be performed inside the G-TEDA.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage (under special circumstances for the Long Beach EZ, the maximum is 202 percent of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Newly enacted state tax law (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17) allows a credit for taxable years beginning on or after January 1, 2009, for a qualified employer in the amount of \$3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time equivalent basis. The credit is allocated by the Franchise Tax Board (FTB) and has a maximum cap of \$400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Any credits not used in the taxable year may be carried forward up to eight years.

Under current state law, Corporation Tax Law allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an "eligible credit" may be assigned by a taxpayer to an "eligible assignee."
 - "Eligible credit" means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.
 - "Eligible assignee" means any "affiliated corporation" that is a member of a combined reporting group at certain specified times.
 - "Affiliated corporation" means a corporation that is a member of a combined reporting group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

Current state law limits the amount of allowable tax credits for each taxable year beginning on or after January 1, 2008, and before January 1, 2010, to an “applicable amount.” “Applicable amount” is equal to 50 percent of the tax before the application of any credits. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed. Taxpayers with business income subject to tax of less than \$500,000 are excluded from this law.

THIS BILL

Beginning on or after January 1, 2009, this bill would provide a tax credit for a qualified employer in an amount equal to 5 percent of the wages of all qualified employees employed by the qualified employer during the taxable year.

This bill would define “qualified employee” as an employee who is employed by the taxpayer and is a resident of California.

This bill would allow unused credits to be carried over until exhausted.

This bill specifies that any deduction allowed for the same qualified wages would not be reduced by the amount of this credit.

In addition, this bill would provide rules for aggregating affiliated employers for purposes of determining an employee tax credit. FTB would be allowed to prescribe appropriate regulations to carry out the purpose of the preceding sentence, including any regulations necessary to avoid the application of this paragraph through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill uses terms that are undefined, i.e., “qualified employer” and “wages.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill is silent regarding the assignment of this business tax credit. Beginning on or after January 1, 2009, a taxpayer that is a member of combined reporting group can assign business tax credits to taxpayers within that group. Assigned credits can only be applied to reduce a tax liability in taxable years beginning on or after January 1, 2010. Consequently, under existing law, any assigned business tax credit would not be claimed until taxable years beginning on or after January 1, 2010. In the absence of language to the contrary, this credit could be assigned to other members of a combined reporting group.

In addition, because this bill provides for a tax credit for the same period for which credits are limited to 50 percent of tax liability, it would be subject to the 50 percent limit under current law. If this is not the author's intent, it recommended the bill be amended to exclude the credit from the 50 percent limitation.

TECHNICAL CONCERN

This bill provides rules for aggregating affiliated employers for purposes of determining an employee tax credit. Because there is no limit on the number of employees or the amount of wages per employer, the rules for aggregating employers are irrelevant to this credit. It is recommended that the bill be amended to delete these provisions. Department staff is available to work with the author's office to resolve this concern.

LEGISLATIVE HISTORY

ABX3 15 (Stats. 2009, Ch. 10) and SBX3 15 (Stats. 2009, Ch. 17) provided a credit of \$3,000 for each net job increase for taxable years beginning on or after January 1, 2009. The credit is allocated by FTB and repealed on December 1 of the following year which the maximum limit of \$400 million is allocated to taxpayers.

SB 508 (Runner 2009/2010) would provide a tax credit for a qualified taxpayer on the first \$6,000 of wages paid or incurred to a qualified employee. This bill is currently in the Senate Revenue and Taxation Committee.

SB 612 (Runner 2009/2010) would provide a tax credit of \$500 per month for each qualified employee employed by a taxpayer. This bill is currently in the Senate Revenue and Taxation Committee.

AB 2365 (Correa, 2003/2004) would have allowed a credit for wages paid to a qualified employee who is hired in the taxpayer's manufacturing trade or business. This bill failed passage out of the Assembly Appropriations Committee.

SB 1523 (Ashburn, 2003/2004) would have allowed a hiring credit to employers with fewer than 19 employees. This bill failed passage out of the Senate Appropriations Committee.

SB 1876 (Alpert, 2003/2004) would have, among other things, created a Living Wage Opportunity and Revitalization Credit and repealed the Economically Developed Area hiring credits. SB 1876 was amended on April 29, 2004, to be a California earned income tax credit. This bill failed passage out of the Senate Appropriations Committee.

OTHER STATES' INFORMATION

Florida allows businesses located in an EZ a credit based on wages paid to new employees. Other wage-based credits are offered to businesses that are located in high crime areas or in rural areas.

New York allows a wage credit to a business that hires a full time employee (either one in targeted group or not) for a newly created job in an Empire Zone.

Illinois allows a job tax credit for taxpayers conducting a trade or business in an EZ or a High Impact Business. The credit is \$500 for each eligible employee hired to work in the zone during the tax year. It is available for eligible employees hired on or after January 1, 1986.

Massachusetts allows a Full Employment credit to employers who participate in the Full Employment Program and continue to employ a participant for at least one full month. The taxpayer may claim a credit of \$100 per month of eligible employment per participant, up to \$1,200 per participant.

Michigan and *Minnesota* do not offer wage credits.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 340 as Introduced on February 18, 2009 For Taxable Years Beginning On or After January 1, 2009 Enactment Assumed After June 30, 2009 (\$ in Billions)			
Fiscal Year	2009-10	2010-11	2011-12
Revenue Loss	-\$7.5	-\$11.0	-\$11.0

This analysis does not consider the possible changes in investment activity, employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact would depend on the amount of qualified wages paid to qualified employees by qualified employers and the amount of credits that would be applied to reduce tax liabilities each year. Department data indicate that California residents receive approximately \$665 billion in wages for taxable year 2006. For taxable year 2009, wages are projected to be 110 percent higher than tax year 2006 wages or approximately \$730 billion (\$665 billion in wages x 110%). It is assumed that 5 percent or approximately \$36 billion (\$732 billion x 5%) of these wages would be paid by non-qualified employers, with the remaining 95 percent or approximately \$695 billion (\$730 billion x 95%) subject to the credit.

Applying a credit rate of 5 percent would generate approximately \$34.7 billion (\$695 billion x 5% credit rate) in credits. Because large businesses would be limited to a 50 percent credit limitation to apply toward their liability in taxable year 2009, it is assumed that 15 percent or approximately \$5.2 billion (\$34.7 billion generated credits x 15%) in credits would reduce tax liabilities for taxable year 2009. Any remaining credits would be carried over to future tax years. Taxable year estimates are converted to fiscal year cash flow estimates in the table.

POLICY CONCERNS

Because this bill fails to specify otherwise, a taxpayer could claim the credit proposed by this bill, a deduction for qualified wages, the EZ Hiring Credit or the Local Agency Military Base Recovery Credit, and the newly enacted Job Tax Credit (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17) using the same employee wages. Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense in order to eliminate multiple tax benefits.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

This bill contains provisions that would limit the credit to employers that employ residents of California while denying the same incentive if nonresidents are employed. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to favor employers that hire or have hired California residents as “qualified employees.”

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